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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION
OF CHAPARRAL CITY WATER
COMPANY, INC., AN ARIZONA
CORPORATION, FOR A
DETERMINATION OF THE CURRENT
FAIR VALUE OF ITS UTILITY PLANT
AND PROPERTY AND FOR INCREASES
IN ITS RATES AND CHARGES FOR
UTILITY SERVICE BASED THEREON.

DOCKET NO. W-02113A-04-0616

On remand from the Arizona Court
of Appeals, No. 1 CA-CC 05-0002

**NOTICE OF FILING
TESTIMONY SUMMARY**

Pursuant to the Procedural Order dated June 25, 2007, Chaparral City Water Company ("Company"), an Arizona corporation, hereby submits this Notice of Filing Testimony Summary in the above-referenced matter. The Company expects to call Thomas J. Bourassa as a witness on Tuesday, January 29, 2008 and attach his testimony herewith.

DATED this 25th day of January, 2008.

FENNEMORE CRAIG, P.C.

By

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Arizona Corporation Commission
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1 **ORIGINAL** and 13 copies of the foregoing
2 delivered for filing this 25th day of January, 2008, to:

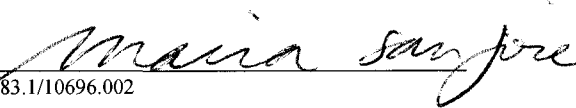
3 Docket Control
4 Arizona Corporation Commission
5 1200 W. Washington St.
6 Phoenix, AZ 85007

7 **COPY** hand-delivered this 25th day of January, 2008 to:

8 Teena Wolfe, Esq.
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13 Phoenix, AZ 85007

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CHAPARRAL CITY WATER COMPANY

Docket No. W-02113A-04-0616
On remand from the Arizona Court
of Appeals, No. 1 CA-CC 05-0002

Summary of Remand Testimony of Thomas J. Bourassa

Mr. Bourassa is a Certified Public Accountant who provides accounting and consulting services to businesses, including utilities. Mr. Bourassa prepared direct, rebuttal and rejoinder testimony for Chaparral City Water Company ("Chaparral City" or "the Company"), focusing primarily on the revenue requirement. This testimony included development of the Company's original cost rate base ("OCRB") and reconstruction cost new less depreciation ("RCND") rate base (B schedules); its income statement, including adjusted test year revenue and operating expenses (C schedules); and its capital structure and capitalization (D Schedules). Mr. Bourassa also testified before the Arizona Corporation Commission ("Commission") during the hearing held in 2005.

In connection with the remand phase of this case, Mr. Bourassa prepared the schedules that were attached to the Company's Amended Notice of Filing Revised Schedules of Rates and Charges for Utility Service, filed in this docket on July 6, 2007. Mr. Bourassa also prepared remand rebuttal and rejoinder testimony and related remand schedules A-1, C-1, C-2, and H on behalf of Chaparral City, which generally address the following aspects of Chaparral's position on remand:

- (1) Revenue Requirement
- (2) Surcharge to Recover the Past Revenue Deficiency
- (3) Property Tax and Income Tax Adjustments to Test Year Operating Income
- (3) Rate Case Expense

A summary of the key issues addressed in Mr. Bourassa's pre-filed testimony follows.

I. REVENUE REQUIREMENT

The Company's proposed operating income is \$1,545,863. This results in an overall revenue requirement of \$7,720,106, which is \$1,517,262 (about 5.75 percent) greater than the revenues approved in Decision 68176. As shown on schedule A-1 page 2, attached to Mr. Bourassa's rejoinder testimony, the average 3/4-inch metered customer using 9,187 gallons will experience an increase of \$1.95 or 5.69 percent on their monthly bill.

In his pre-filed testimony in this remand proceeding, Mr. Bourassa explained that the rate of return of 7.6 percent authorized by the Commission in Decision No. 68176 (Sept. 30, 2005) should be applied to the fair value rate base ("FVRB") to determine the operating income and revenue requirement.

Mr. Bourassa explains that the weighted average cost of capital ("WACC") is applicable to the rate base required to be used by the Commission in setting rates, which is the fair value rate base ("FVRB"). He also explains that a return derived through the WACC is not exclusively linked to an original cost rate base ("OCRB") in Arizona. The WACC is determined independently of the utility's rate base, and is applied to the rate base regardless of whether the amount of invested capital in the capital structure is equal to the rate base. Moreover, the cost of equity used in the WACC is estimated by means of market-based finance models that do not consider or otherwise depend on the rate bases, the book values of debt and equity, or the book returns of the publicly traded water utility companies used in these models.

Mr. Bourassa acknowledges that the Commission uses a curious mixture of market-based equity costs and book weights of debt and equity in the WACC. However, as Mr. Bourassa explains, an assertion the WACC is linked to the OCRB ignores the anomalies created by using market-based equity returns to determine the rate of return that is applied to the OCRB. Book value weights of debt and equity used in the WACC can be justified, but none of the reasons depend on the type of rate base used to set rates. Mr. Bourassa shows that when the rate of return methodology is more reasonably related to the rate base methodology, a higher return than the authorized return of 7.6 percent is indicated. He discusses two alternative methods for computing a return on FVRB, both of which result in higher returns than the 7.6 percent return authorized previously by the Commission.

Mr. Bourassa addresses Staff's methods of developing a rate of return, which rely on the premise that the capital costs that a utility is entitled to earn should be limited to the amount of its historic investment in plant. Consequently, Staff's methods are designed to produce the same or similar results that would be produced as if Arizona were an original cost jurisdiction. Mr. Bourassa points out that the standard in Arizona is fair value and the amount of investment is immaterial.

Mr. Bourassa also addresses the method proposed by RUCO, which is based on an alleged "double counting" of inflation and is based upon incorrect facts, assumptions, and concepts. Like Staff, RUCO relies on original cost and prudent investment arguments as the basis for its methodology and recommendation. Mr. Bourassa points out that while RUCO asserts the standard for a fair return is WACC applied to OCRB, RUCO's method produces an operating income over \$162,000 less than the WACC applied to the OCRB, and therefore should be rejected on this fact alone.

II. SURCHARGE TO RECOVER PAST REVENUE DEFICIENCY

Based on the Company's proposed revenue requirement, Mr. Bourassa computed the amount to be recovered by means of a temporary surcharge. The surcharge would recover a total of \$1,097,640, comprised of the historic revenue deficiency (from October 1, 2005, until May 1, 2008), carrying costs on the deficiency (based on the WACC), and rate case expense. *See* Bourassa Rejoinder, Schedule A-1, page 1, ls. 23-38. The Company proposes that the surcharge be collected for a period of 12 months or until full recovery has been made. As shown on Schedule A-1, page 2, the surcharge is commodity-based, and would be equal to \$0.582 per 1,000 gallons. For an average 3/4-inch metered customer using 9,187 gallons, the monthly

surcharge would be \$5.35. Together with the increase in base rates of \$1.95 or 5.69 percent and during the period in which the surcharge is collected, an average 3/4-inch metered customer will pay an additional \$7.30 per month or 21.26 percent higher than the rates approved in Decision 68176.

III. PROPERTY TAXES AND INCOME TAXES

Mr. Bourassa explained the Company's initial proposal to adjust test year operating income for changes to property taxes and income taxes as the result of changing the revenue requirement and required operating income. Staff witness Ralph Smith asserts in his testimony that property taxes should not be adjusted because they were not an issue on appeal. As a matter of rate making, Mr. Bourassa does not agree. However, the Company has accepted Staff's recommendation that property taxes should not be adjusted for purposes of determining the new revenue requirement to eliminate issues on remand and to avoid claims that the Company is taking inconsistent positions in opposing Staff's attempt to adjust the capital structure determined by the Commission in Decision 68176.

IV. RATE CASE EXPENSE

Finally, Mr. Bourassa addresses the Company's request to recover \$100,000 of rate case expense for the costs of successfully appealing Decision No. 68176 and the remand proceeding. This is about half of the amount the Company expects to incur. Mr. Bourassa explains that the amount of rate case expense approved in Decision No. 68176 did not include a subsequent appeal or other proceedings. The "normalized" rate case expense will not provide recovery since, as Mr. Bourassa points out, the Company filed another rate case well before the end of the 4-year amortization period used to determine the amount of rate case expense to be included in operating expenses. In its new application, the Company did not include the costs of appeal and the remand proceeding. Absent recovery as requested, the Company would simply be denied recovery of these additional costs.

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